

**Office of Chief Counsel
Internal Revenue Service**

memorandum

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date:

to: Manager, Technical Support Group
SBSE:TS:PKosmatka

from: Associate Area Counsel
Small Business/Self-Employed:Area 4

subject: **Opinion - I.R.C. § Section 2057 and Estate Tax Liens**

This responds to your request for an opinion.

ISSUES

1. May the Service file a lien on shares of corporate stock, where such stock constitutes § 2057 qualified family owned business interests?

2. May the Service require the estate to substitute collateral in lieu of stock?

3. May the Service require additional security if the qualified family owned business interests decrease in value.

4. May the Service file a notice of lien on a § 2057 interest in a partnership or LLC?

5. If the lien on real property is sufficient to cover the additional tax liability, must the Service file a notice of lien with respect to the § 2057 personal property?

6. Must the Service use exact and detailed identifying information with respect to personal property on the notice of the § 2057 lien (such as make, model, serial number, and vehicle ID number)?

7. Does a § 2057 lien cover offspring of livestock and new crops?

8. What names should appear on the notice of lien?

9. Do the place of filing rules for the general tax lien apply with respect to the § 2057 lien?

10. Must the Service secure a consent to the § 2057 lien?

CONCLUSIONS

1. The Service may file a lien on stock; however, because the rules on the effectiveness of such notice are not clearly established, we recommend that the Service take possession of the stock or have the certificates marked subject to the § 2057 lien.

2. The Service may not require the estate to substitute collateral in lieu of the stock.

3. The Service may not require additional security if the qualified family owned business interests decrease in value.

4. The Service may file a notice of lien on an interest in a partnership or LLC.

5. The failure of the Service to file a notice with respect to the personal property does not invalidate the notice with respect to real property; however, nonfiling results in the lien on personal property being invalid as against any purchaser, holder of a security interest, mechanic's lien or judgment lien.

6. The Service need not use exact and detailed identifying information with respect to personal property on the notice of the § 2057 lien (such as make, model, serial number, and vehicle ID number). The Service should reasonably identify the property.

7. A § 2057 lien covers the offspring of livestock and new crops.

8. The names of the qualified heirs owning the qualified family owned business interests should appear on the notice of lien.

9. The I.R.C. § 6323(f) place of filing rules for the general tax lien apply with respect to the § 2057 lien.

10. No consent to the § 2057 lien needs to be secured by the Service.

FACTS AND ANALYSIS

In determining the amount of the taxable estate, I.R.C. § 2057(a)(1) allows an estate to deduct from the gross estate the adjusted value of qualified family owned business interests. The deduction is limited in amount to \$675,000.

Section 2057 allows certain trade or business interests to pass from the decedent to qualified heirs without the imposition of estate tax. An additional tax is imposed upon the estate under certain circumstances where, within 10 years of the decedent's death and prior to the death of the qualified heir, a qualified heir fails to materially participate in the business or disposes of the business interests. I.R.C. § 2057(f). Qualified heirs include members of the decedent's family and active employees who have been employed by the trade or business for a period of at least 10 years prior to the decedent's death. I.R.C. § 2057(i)(1). The Code contains provisions designed to help assure the ability of the government to collect any additional tax liability that may accrue.

Qualified heirs are personally liable for any additional estate tax attributable to that qualified heir's interest in a qualified family-owned business interest unless the qualified heir has furnished a form of bond in lieu of personal liability. The amount of the bond must cover the maximum amount of the additional liability that may result. I.R.C. §§ 2057(i)(3)(F), 2032A(c)(5), and 2032A(e)(11). For purposes of § 2057, rules similar to those under I.R.C. § 6324B, relating to special liens for additional estate tax, apply. I.R.C. § 2057(i)(3)(P). Applying rules similar to those under I.R.C. § 6324B provides the Service with a lien on the qualified family owned business interests for the maximum amount of the additional liability that may arise under I.R.C. § 2057(f)(2). See I.R.C. § 6324B(a). Notice of the lien must be filed to be effective as against certain other interests. I.R.C. §§ 6324B(c)(1) and 6324A(d)(1). Security acceptable to the IRS may be substituted for the lien. See I.R.C. § 6324B(d).

1. Does Filing a Notice of Lien on Shares of Corporate Stock Fully Protect the Interests of the Government

Some estates making the § 2057 election contain qualified family owned business interests in the form of interests in an incorporated business. The interest in shares of corporate stock constitutes property subject to the lien securing the maximum amount of additional tax liability that may arise under § 2057(f)(2). A question arises as to the extent to which the IRS lien in the stock is protected as against other potential creditors claiming a security interest in the stock.

Instead of specifying rules regarding the Service's lien in § 2057 property, I.R.C. § 2057(i)(3)(P) provides that, for purposes of sct 2057, "[r]ules similar to the . . . rules" of § 6324B (relating to the special lien for additional estate tax) shall apply.

I.R.C. § 6324B provides the Service with a lien on certain farm, trade, or business real property, where the value of the property is not included in the taxable estate pursuant to I.R.C. § 2032A. I.R.C. § 2032A(c) provides for an additional estate tax if qualified heirs dispose of or cease to use for qualified purposes the qualified real property. Notice of this lien must be filed in order to be valid as against any purchaser, holder of a security interest, mechanic's lien, or judgment lien creditor. I.R.C. §§ 6324B(c)(1) and 6324A(d)(1). Also, even if the Service files notice of the § 6324B lien on real property, it is not valid as against liens for property taxes, mechanic's liens for real property improvements, or real property construction or improvement financing agreements. I.R.C. §§ 6324B(c)(1) and 6324A(d)(3).

In interpreting the requirements of I.R.C. § 2057(i)(3)(P) we must determine what is meant by "similar to". Directly applying the rules of § 6324B, the government can argue that since the § 6324B lien on § 2032A property is not effective as against purchasers, security interest holders, mechanic's liens, or judgment liens until the Service files notice of the lien, then the lien on § 2057 property is not effective as against the same until the Service files notice of it. Even with the filing of the notice, neither lien is effective as against certain superpriorities: property tax liens, mechanic's liens for improvements to real property, and real property construction financing agreements.

From this direct application of the § 6324B rules, we would conclude that filing notice of the § 2057 lien on shares of stock protects the Service as against purchasers, security interest holders, mechanic's liens and judgment liens on the shares of stock. Section 6324B contains no superpriority with respect to sales of or liens on shares of stock arising after the filing of the notice of lien; therefore, the government may argue that no superpriority on the purchase of or liens on shares of stock exists with respect to the § 2057 lien.

However, determining the extent that the rules regarding the § 2057 lien are "similar to" the rules of the § 6324B lien may require a more complicated analysis, one we think a court may well adopt. The rules of the § 6324B lien relate to the qualified real property described in I.R.C. § 2032A. The limitations on the lien closely follow the limitations of I.R.C. § 6323 with respect to

liens on real property. Thus, as in I.R.C. § 6323(a), notice of the lien must be filed in order to be effective as against purchasers, security interest holders, mechanic's liens, and judgment liens. And, as in I.R.C. § 6323(b), even if notice is filed, the § 6324B lien on real property is not effective as against property tax and certain other liens on real property. The rules regarding the § 6324B lien do not include the other superpriorities set forth in I.R.C. § 6323(b), as those limitations do not apply to real property. We believe a court is likely to find that it is the purpose of the statutory scheme to apply the limitations and restrictions of § 6323(a) and (b) to the § 6324B and the § 2057 liens.

In determining the limitations and restrictions on the § 2057 lien on personal property, we recommend taking account of the restrictions of I.R.C. § 6323(a) and (b). As with the § 6324B lien, the § 2057 lien must be filed in order to be effective as against purchasers, security interest holders, mechanic's liens, and judgment liens (the rule of I.R.C. § 6323(a)). Unlike the § 6324B lien, the § 2057 lien may attach to personal property. Applying the rules of § 6323(b), even if notice is filed, the § 2057 lien would not be effective as against purchasers or holders of security interests in securities (where the purchasers or holders of security interests did not have actual notice or knowledge of the tax lien). See I.R.C. § 6323(b)(1).

The Service may file a notice of lien with respect to shares of stock. However, we believe a court may find that even with the filing of the notice, the § 2057 lien would not be effective as against purchasers or holders of security interests in the shares of stock, unless the purchasers or holders of security interests had actual notice or knowledge of the § 2057 lien. To protect its lien interest in the shares of stock, we recommend that the Service take possession of the certificates or have them dated and marked subject to the IRS lien for the maximum amount of additional § 2057 tax. The shares of stock may also serve as security where they are placed in an escrow account that restricts any sale or lien on the certificates until the estate no longer has any potential liability for the § 2057 tax.

The lien may be enforced in the manner in which the Service enforces other liens. The Service may administratively sell or bring a suit to foreclose the lien on the stock. See Estate of Pearce, 347 F. Supp. 1129 (D. Del. 1972) (stock in corporation owned by decedent subject to estate tax lien).

If the Service simply relied upon the filing of the notice of tax lien on the stock, it faces the problem of priority claims by purchasers and holders of security interests in the stock. The

Service would have to make the argument the filing of the notice protects the Service as against purchasers and holders of security interests because that is all that is required by the express terms of § 6324B and the provisions of § 6324A incorporated into § 6324B.

If for some reason you decide to simply file notice of the lien in the stock, the place for filing should be governed by the rules for personal property and the residence of the qualified heir owning the stock. See I.R.C. § 6323(f)(1)(A)(ii). As the shares of stock are owned by the qualified heirs, the place of filing would not be governed by the last residence of the decedent or the state where the corporation is located.

2. May the Service Require Bond or Other Collateral in Lieu of a Lien on Shares of Stock

I.R.C. § 6324B provides that "the furnishing of security may be substituted for the lien imposed by this section" to the extent that the regulations so provide. Treas. Reg. § 20.6324B-1(c) provides that upon written application of the qualified heir, the Service may issue a certificate of discharge with respect to the qualified real property, after receiving a bond or other security sufficient to secure payment of the maximum potential additional tax liability. Applying this provision to § 2057, the Service may require a bond if the qualified heir requests a discharge of lien from the qualified property consisting of shares of stock. We do not read this regulatory provision as allowing the Service to require a bond in situations where the Service would prefer not to have to rely on a lien on shares of stock.

We note that I.R.C. § 6165 provides that, where the Service grants an extension of time to pay tax, it may require the furnishing of bond to secure payment of the tax. We do not think that this provision would allow the Service to require a bond in lieu of shares of stock to secure a § 2057 potential liability, as the potential liability does not involve the Service granting an extension of time to pay tax. The potential liability under I.R.C. § 2057(f)(2) is described as "an additional estate tax" triggered by the occurrence of an event. We would not describe the situation as one involving the Service granting an extension of time to pay tax.¹

¹ We note that I.R.C. § 6324A(d)(6) provides that § 6165 does not authorize the Service to require a bond when the estate and heirs sign an agreement granting the Service a lien in property securing payment of the estate tax deferred under § 6166. The rules set forth in I.R.C. § 6324A(d)(1), (2), and (3) and the regulations thereunder are incorporated into § 6324B.

Though the Service may not require the substitution of collateral, we see nothing in the Code that prohibits the Service from requesting it. See I.R.C. § 6324B(d) (which states that "the furnishing of security may be substituted for the lien imposed by this section" to the extent provided in regulations.) In some cases, the qualified heirs may prefer to provide a bond or other collateral rather than encumber the shares of stock in the family owned business, especially if they need the shares of stock as collateral to obtain financing for the business.

3. Additional Security if the Value of the Qualified Family Owned Business Interests Decreases

Under I.R.C. § 6324A(d)(5), the Service may require additional security if the value of the property securing the § 6324A lien falls below the amount of the tax and interest deferred under I.R.C. § 6166. This provision was not incorporated into § 6324B or § 2057. Nor do any other provisions specifically authorize the Service to require additional security if the value of the qualified family owned business interests falls below the maximum amount of the potential additional tax liability.

Applying the rule of I.R.C. § 6324B, the lien securing the potential additional § 2057 tax liability attaches to qualified family owned business interests. The rule does not limit the value of the property to which the lien attaches. The property, therefore, should exceed the amount of the potential liability, thereby affording the Service some protection should the property decrease in value. We recognize, however, that as time passes the potential interest liability can consume much of the excess value.

The Code does not require the Service to monitor § 2057 stock cases. The decision to do so is an administrative one best addressed by your office.

4. Filing a Notice of Lien on an Interest in a Partnership or LLC

You ask whether the Service may file a lien on a decedent's interest in a partnership or LLC. Oftentimes such interests, especially with regard to partnerships, cannot be passed from a decedent to an heir. The partnership or LLC agreement should

Section 6324A(d)(6) is not incorporated, as that rule covers bonds on the payment of deferred estate tax. Section 6324B, like § 2057, does not involve the deferred payment of estate tax; rather, these sections involve the additional estate tax liability that may be triggered by a future event.

contain provisions as to the manner in which a decedent's interest is handled upon death.

If a decedent's interest in a partnership or LLC passes on to a qualified heir as a qualified family owned business interest, a lien attaches to the interest securing the maximum potential additional tax liability. I.R.C. §§ 2057(i)(3)(P) and 6324B. The lien attaches whatever rights the interest entails. If those rights do not include the right to sell the interest, the Service will be unable to sell the interest. The Service may be left with whatever rights to payment, distributions, or liquidation that the interest includes. On the other hand, if the interest includes the right to sell the interest, the Service may then sell the interest (upon default in paying any additional tax liability).

The notice of lien should describe the nature of the interest in a manner adequate to notify an average person of the Service's lien in the interest. This would include the name of the qualified heir holding the interest, the extent of the interest, and the name and address of the partnership or LLC.

If the interest is evidenced by any certificates of ownership, we recommend taking steps similar to the cases involving shares of stock. The Service should take possession of the certificates or have them marked subject to the § 2057 lien. And, as with shares of stock, the Service may enter into an escrow agreement that prohibits release of the certificates until the potential additional tax liability no longer exists.

5. Filing a Notice on Personal Property When the Notice on Real Property Sufficiently Protects the Service

The Service may file a notice of lien on real estate sufficient to cover the amount of the maximum potential additional tax liability. You ask whether the Service must file a notice with respect to personal property that may be covered by the § 2057 election.

However, the failure of the Service to file a notice with respect to the personal property results in the lien being invalid as against any purchaser, holder of a security interest, mechanic's lien or judgment lien. I.R.C. §§ 2057(i)(3)(P), 6324B(c), and 6324A(d)(1).

Filing a notice on the personal property merely provides the Service with additional security. We recommend filing a notice of lien with respect to personal property if there is any chance that the real property could possibly prove to be insufficient to cover

the amount of the maximum potential additional tax liability.

6. Content of Notice of § 2057 Lien

The Form 706, United States Estate Tax Return (and Generation-Skipping Transfer) does not generally contain detailed identifying information on personal property. You ask about the extent of the identifying information that the Service needs on notice of the § 2057 lien (such as make, model, serial number, and vehicle ID number).

I.R.C. § 2057(i)(3)(P), referencing I.R.C. § 6324B, which, in turn, incorporates I.R.C. § 6324A(d)(1), (3), and (4), provides for a special lien for the potential § 2057 additional tax. To be effective as against purchasers, holders of a security interest, mechanic's lien, or a judgment lien, a notice of the lien must be filed in accordance with the requirements of I.R.C. § 6323(f). I.R.C. § 6323(f)(3) provides as follows:

[t]he form and content of the notice . . . shall be prescribed by the Secretary. Such notice shall be valid notwithstanding any other provision of law regarding the form or content of a notice of lien.

The form and content of a § 2057 notice of lien is not prescribed by regulation. Treas Reg. § 301.6323(f)-(1)(d) provides that the notice of federal tax lien

shall be filed on Form 668, "Notice of Federal Tax Lien Under Internal Revenue Laws". Such notice is valid notwithstanding any other provision of law regarding the form or content of a notice of lien. For example, omission from the notice of lien of a description of the property subject to the lien does not affect the validity thereof even though State law may require that the notice contain a description of the property subject to the lien.

The Service may take the position that the § 2057 notice is to be filed in accordance with the requirements of § 6323(f), and the regulations under § 6323(f) which provide that the notice shall be filed on a Form 668. Such notice is valid notwithstanding any contrary provision of law, including provisions that require a description of the property.

The problem with taking this position, however, is that a court may find that Treas. Reg. § 301.6323(f)-(1)(d) was meant to deal with the general lien of I.R.C. § 6321 and not the more

specific lien of § 2057. A court may find that in lieu of regulations under I.R.C. § 2057 as to the content of the notice, the court will determine reasonable requirements.

Wis. Stat. § 409.110, a provision adopted from the Uniform Commercial Code, states that with respect to secured transactions "any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described." The Uniform Commercial Code commentary for this provision states that this rule rejects the so-called serial number test required by certain older cases, where the court required exact and detailed descriptions. Though the Uniform Commercial Code would not govern the § 2057 lien, we recommend using the Uniform Commercial Code principle with respect to describing § 2057 personal property. The Service should have an effective and enforceable lien if the notice reasonably identifies the personal property securing the lien. This would not require exact and detailed information such as serial or other identification numbers.

No statutory provision specifically authorizes the Service to require additional collateral in the event that the personal property depreciates in value. We recommend that the notice cover all such property to protect the Service in the event that any of the property depreciates in value.

7. Lien on Crops and Livestock

Under the Uniform Commercial Code, a security interest attaches to the proceeds of collateral. See Wis. Stat. § 409.203. Also, a security interest may attach to the after acquired property of the debtor. See Wis. Stat. § 409.204. As the commercial code does not govern the § 2057 lien, it is uncertain of the extent to which these principles may apply.

The § 2057 lien attaches to the qualified family owned business interests. In the case of a farm, the lien would cover livestock and crops. The question arises as to whether the lien attaches to offspring of the livestock and new crops. We can find no authorities that directly address this question. We recommend taking the position that the lien covers the livestock offspring and new crops, as these assets are in effect a continuation of the family owned business interests existing at the time of the decedent's death.

We do not believe that a new notice needs to be filed annually. The notice should be sufficient if it reasonably describes the crops and livestock of the farm to which the lien

applies. We recommend that the lien with respect to crops include the legal description of the land on which the crops grow, unless the crops can be reasonably identified in some other manner.

You ask if the notice of lien on personal property would hinder the qualified heir's ability to do business. We would assume that the notice of lien would be a factor in the qualified heir's effort to obtain financing or credit. Of course, the qualified heir could provide substitute collateral in the event that the notice of lien unduly interfered in business operations. See I.R.C. § 6324B(d).

8. Name of Owner on Notice of Lien

Your office has been filing notice of the § 2057 lien listing the names of the decedent and the qualified heir. You ask about liens involving property titled in the name of an entity other than the decedent.

The § 2057 lien is with respect to qualified family owned business interests that pass from the decedent to qualified heirs. The notice of lien should identify the appropriate qualified heir (and perhaps the decedent if probate administration has not yet caused title to pass to the qualified heir). If the qualified family owned business interest that passes from the decedent to a qualified heir is an interest in a corporation, trust, or other entity, the notice of lien should describe the covered property as the interest in the entity. If reasonably identifying the property requires including details regarding the name and assets of the entity, then include the information.

As a general matter, a lien identifying the names of the decedent and the qualified heir should be sufficient. If you have a peculiar case where you have concerns that such names may be insufficient, please provide details of the situation to our attention for further review.

9. Place of Filing

You ask whether place of filing rules for the general tax lien apply with respect to the § 2057 lien. The same rules apply.

The notice of § 2057 lien should meet the requirements of I.R.C. § 6323(f). See I.R.C. §§ 2057(i)(3)(P), 6324B(c)(1), and 6324A(d)(1), which incorporate the rules of § 6323(f). I.R.C. § 6323(f) prescribes the rules regarding the place for filing notices of the federal tax lien. These are the rules for the general tax lien. These rules also apply with respect to the § 2057 notice of

lien.

10. Consent to Lien

You ask whether the Service must secure a consent to lien. No such consent needs to be secured.

The § 2057 lien is statutory. Section 2057(i)(3)(P) provides for rules similar to those of § 6324B. Section 6324B(a) provides that the amount of tax "shall be a lien in favor of the United States on the" qualified property. The lien arises automatically and no consent needs to be secured. However, we note that in cases where the qualified heir does not want the lien on the property, the heir may provide substitute collateral. I.R.C. § 6324B(d).

If you have any questions on this matter, please call Michael Calabrese of this office at 297-4241. Our file is closed.

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